CHINA'S ECONOMY AT A GLANCE

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National Australia Bank

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CONTACT

Gerard Burg, Senior Economist - International

NAB Group Economics

China’s Delta outbreak likely to slow growth in the near term

- There were some significant signs of weakness emerging in the latest Chinese data. In seasonally adjusted, month-on-month terms, industrial production growth slowed and retail sales fell in July. Similarly, real investment contracted steeply year-on-year. In part, this trend could be related an outbreak of COVID-19 in the second half of July. Starting in Nanjing, this Delta variant outbreak has rapidly spread to other localities, including Beijing. In response, Chinese authorities have introduced mass testing and travel restrictions, along with localised closures of events and businesses. Reflecting the impact of these measures, we have revised down our forecast for 2021 to 8.7% (previously 9.5%), while our forecasts for 2022 (5.9%) and 2023 (5.7%) are marginally stronger.

- China’s industrial production growth slowed further in July, down to 6.4% yoy (from 8.3% yoy in June). The slowdown in growth has been partly related to base effects – given the rapid recovery of China’s industrial sector from its lockdown in February 2020 through to July 2020. However, there was a notable slowdown in production on a seasonally adjusted, month-on-month basis – which could be related to the COVID-19 outbreak.

- China’s real fixed asset investment contracted in July – down by 8.2% yoy (compared with a 1.6% fall in June). Access to finance may be having an impact on investment growth. Government bond issuance has sharply contracted in year-on-year terms, and investment in infrastructure (which is largely financed by local governments) fell by 10.5% yoy in June (in nominal terms).

- China’s trade surplus expanded in July, totalling US$56.6 billion (compared with US$51.5 billion in June). The value of China’s exports was marginally higher month-on-month in July, while there was a slight decline in the value of imports.

- China’s retail sales growth slowed once again – with diminishing base effects a contributor. Real retail sales rose by 6.5% yoy (down from 9.8% yoy previously). Base effects alone do not explain the slowdown – with nominal month-on-month retail sales (seasonally adjusted) decreasing by 0.13% (compared with a 0.48% mom increase in June).

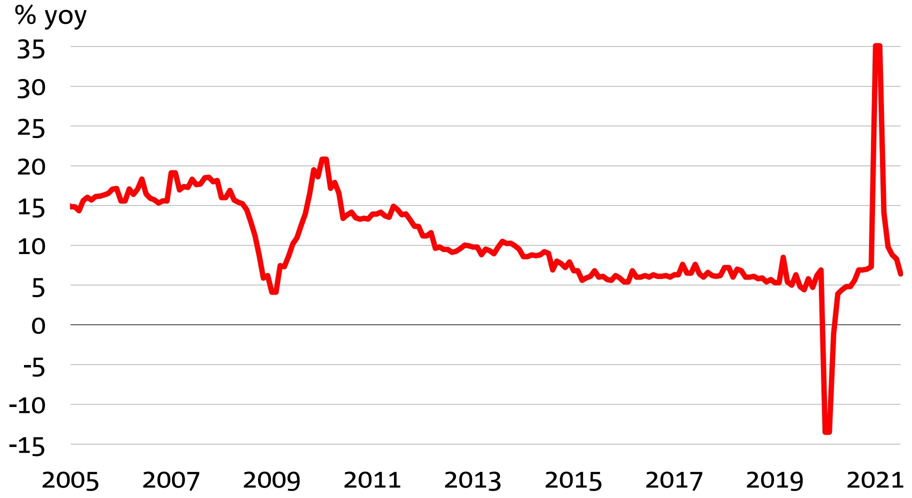
- In the first seven months of 2021, new credit issuance totalled RMB 18.8 trillion, a decrease of 16.8% yoy. During this period, bank lending continued to expand, while non-bank lending has continued to fall – down by over 46% yoy. This decline was led by falls in government and corporate bond issuance.

- The People’s Bank of China (PBoC) argues that producer price inflation is controllable and that interest rates are at “a reasonable level”. However it has flagged downside risk to the economy, which has triggered some speculation of further cuts to the Required Reserve Ratio (similar to the cut in July) or cuts to interest rates.

INDUSTRIAL PRODUCTION

INDUSTRIAL PRODUCTION

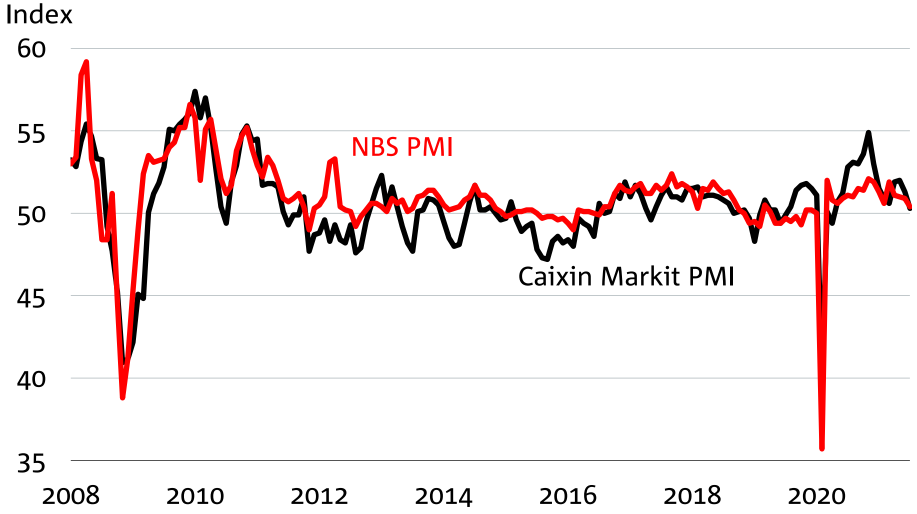
Growth continues to slow; dropping below expected rates in July



Source: CEIC, NAB Economics

MANUFACTURING PMIS CONVERGE IN JULY

Both surveys near neutral levels, with differing export trends



Source: CEIC, NAB Economics

- China's industrial production growth slowed further in July, down to 6.4% yoy (from 8.3% yoy in June). The slowdown in growth has been partly related to base effects – given the rapid recovery of China's industrial sector from its lockdown in February 2020 through to July 2020. However, this growth was below the expected rate of growth (7.9% yoy in the Bloomberg survey).

- There was a notable slowdown in production on a seasonally adjusted, month-on-month basis. Growth eased to 0.3% mom in July, from 0.56% mom in June – which had been broadly around the trend rate of growth from November 2020 onwards. It is possible that this slowing reflects measures to slow China's Delta variant COVID-19 outbreak from mid-July.

- There were significantly divergent trends at the sub-sector level in July. Production of electronics rose strongly – up by around 13.0% yoy – while electricity output rose by 9.6% yoy. In contrast, cement manufacturing fell by 6.5% yoy, crude steel output by 8.5% yoy and motor vehicles by 15.8% yoy.

- Both of China's major manufacturing surveys weakened in July, moving close to neutral levels. The official NBS PMI eased to 50.4 points (from 50.9 points previously). The decline in the private sector Caixin Markit PMI was larger – down to 50.3 points (from 51.3 points in June).

- While the two surveys converged, there were some notable differences within sub-components. The new export orders measure in the NBS PMI has been negative since May, and deteriorated further in July. In contrast, this measure in the Caixin Markit survey was marginally positive in July, and slightly stronger than in June.

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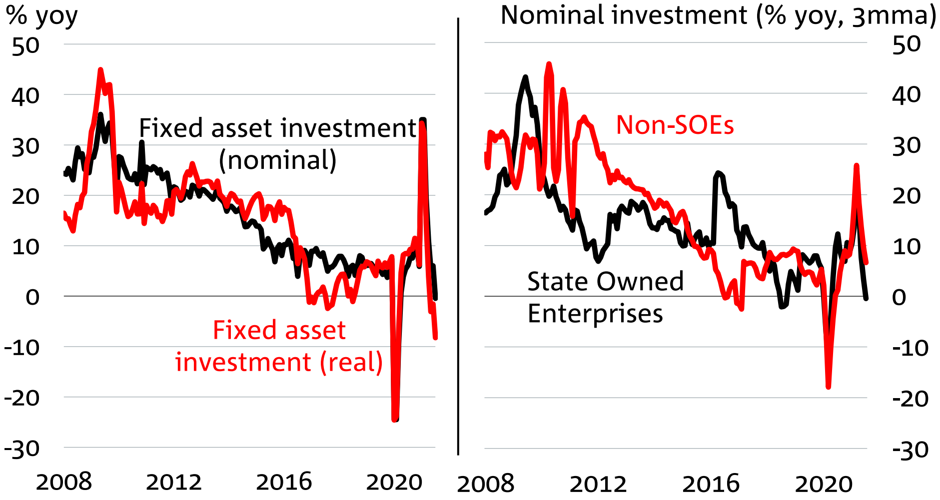
INVESTMENT

FIXED ASSET INVESTMENT

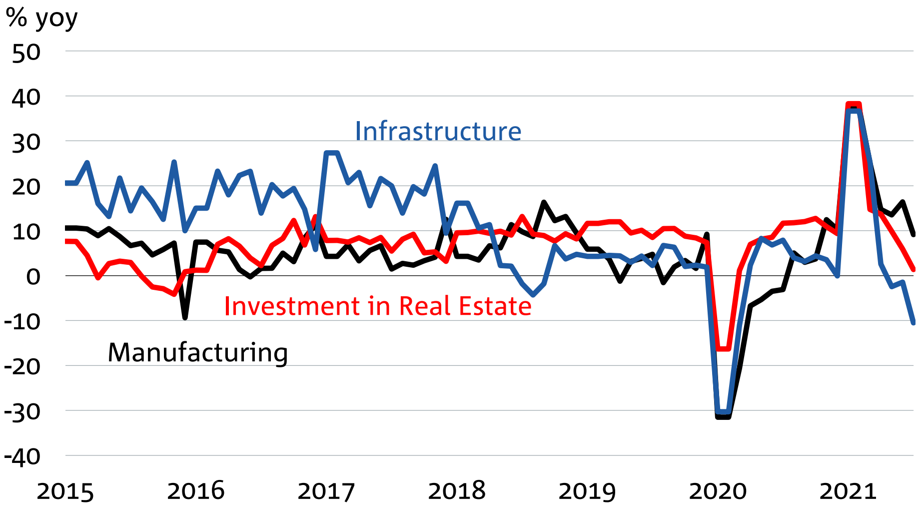
Sharp slowdown in investment in July, led by SOEs



Source: CEIC, NAB Economics

FIXED ASSET INVESTMENT BY INDUSTRY

Infrastructure sharply contracted, real estate also weak



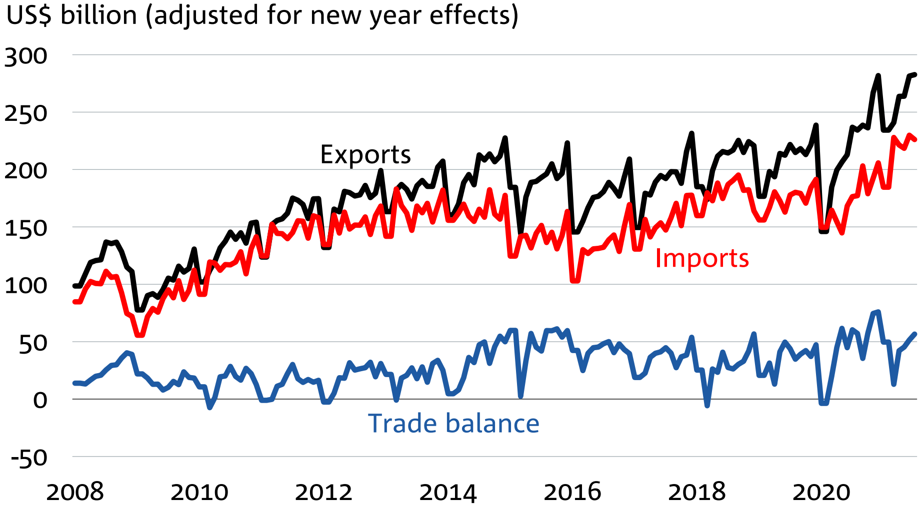
Source: CEIC, NAB Economics

- China's nominal fixed asset investment contracted slightly in July – down by 0.4% yoy (compared with a 6.0% yoy increase in June). Rising producer prices – which flow through into the cost of investment goods – resulted in a steep decline in real investment – down by 8.2% yoy (compared with a 1.6% fall in June).
- Access to finance may be having an impact on investment growth. Government bond issuance has sharply contracted in year-on-year terms, and investment in infrastructure (which is largely financed by local governments) fell by 10.5% yoy in June (in nominal terms).
- Investment in real estate has also slowed significantly – with growth at just 1.4% yoy (the weakest rate of increase since March 2020). In contrast, investment in manufacturing continued to grow – up by 9.1% yoy – albeit slowing from double digit growth rates in recent months.
- The decline in nominal investment is more evident in the state-owned sector – with SOE investment declining by 4.8% yoy in July (from a 4.6% increase in June). In contrast, investment by private sector firms grew – albeit more slowly – by 2.1% yoy (down from 6.1% yoy previously).

INTERNATIONAL TRADE – TRADE BALANCE AND IMPORTS

CHINA'S TRADE BALANCE

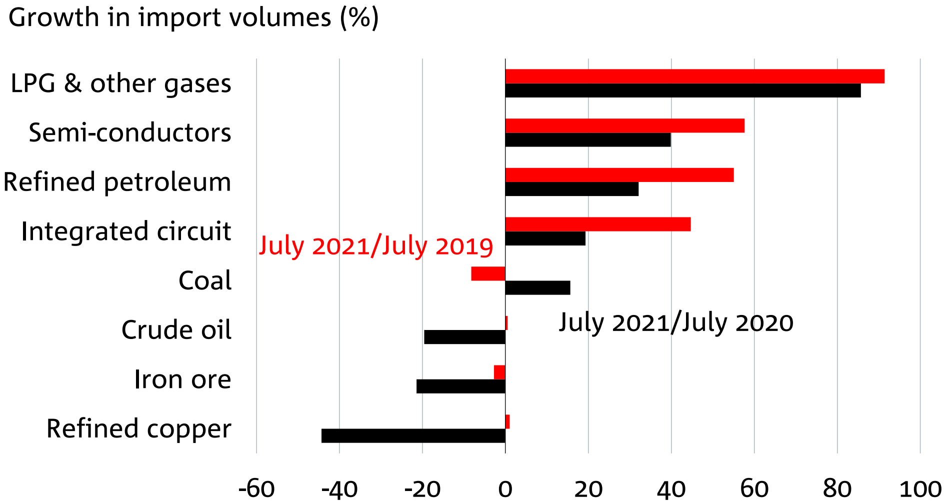
Trade surplus higher on marginal fall in import values



Sources: CEIC, NAB Economics

IMPORT VOLUMES BY PRODUCT

Strong growth in advanced tech & refined products



Source: CEIC, NAB Economics

- China's trade surplus expanded in July, totalling US$56.6 billion (compared with US$51.5 billion in June). The value of China's exports was marginally higher month-on-month in July, while there was a slight decline in the value of imports.

- China's trade surplus with the United States has grown in recent months. On a rolling twelve month basis, the surplus rose to a new record of US$364.2 billion, the sixth month in a row that there has been a new record.

- The total value of China's imports was US$226.1 billion in July, down from US$229.9 billion previously. In year-on-year terms, imports rose by 28.1%, down from 36.7% in June – with the slowdown in part reflecting smaller base effects, with the recovery in imports more advanced in July 2020 (compared with previous months).

- Rising commodity prices have contributed to the increase in China's import values. In US dollar terms, the RBA Index of Commodity Prices rose by almost 64% yoy in July. Our estimate of import volumes uses these commodity prices as a proxy for China's import prices, and this suggests that volumes rose by 9.4% yoy in July (down from 18.5% yoy in June) – once again reflective of diminishing base effects.

- This overall increase in export volumes was not particularly apparent in commodities – with imports of a range of key commodities decreasing year-on-year. This included a 44% yoy fall in refined copper imports, a 21% yoy decline in iron ore and a 20% decrease in crude oil volumes. One exception was coal, where volumes rose by 15.6% yoy.

- Instead, there were large increases in a range of refined products and advanced technologies. Imports of Liquefied Petroleum Gas and other gases, semi-conductors, refined oil products and integrated circuits all rose comparatively strongly in July, both in year-on-year terms and when compared with levels in July 2019.

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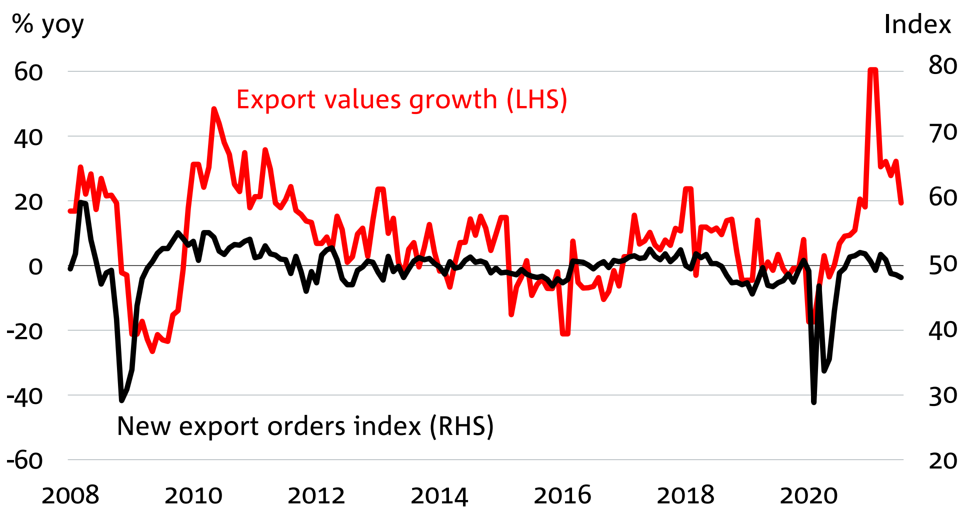
INTERNATIONAL TRADE – EXPORTS

EXPORT VALUE AND NEW EXPORT ORDERS

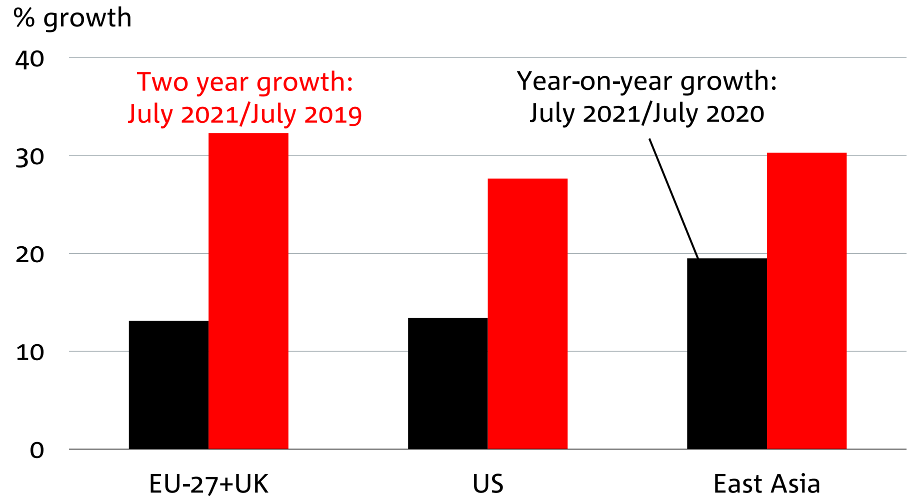
Export growth continues to slow as base effects decline



Source: CEIC, NAB Economics

EXPORTS TO MAJOR TRADING PARTNERS

Compared with July 2019, fastest growth in exports to Europe



Source: CEIC, NAB Economics

- China's exports rose marginally in July, increasing to US$282.7 billion (compared with US$281.4 billion in June) – a new record high. In year-on-year terms, this was an increase of 19.3%. While the growth rate has slowed in recent months, this largely reflects the declining impact of base effects – given China's comparatively rapid industrial recovery from COVID-19 restrictions in 2020.

- Strong growth in exports is not expected to last in coming months. The new export orders measure in the NBS PMI survey was weaker in July – down to 47.7 points (from 48.1 points previously). Similarly, the People's Bank of China have flagged weaker export growth as a downside risk to China's economy in its most recent monetary policy report.

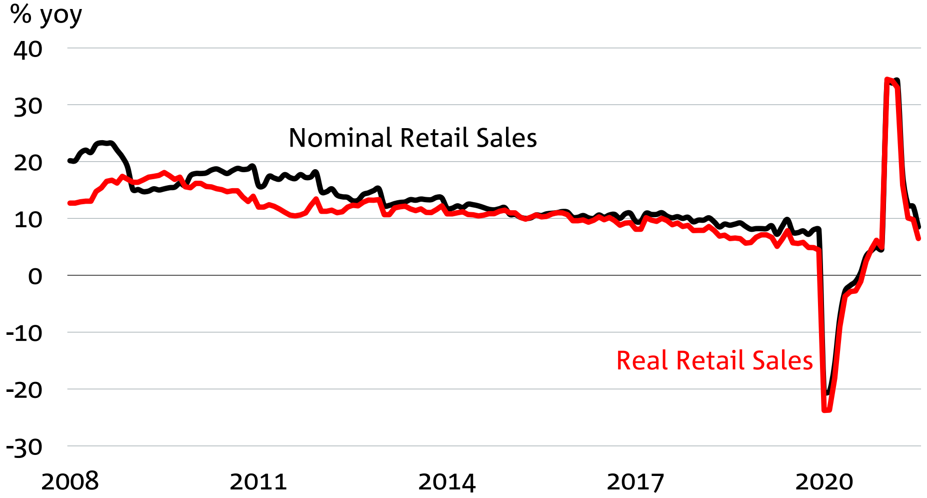
- Growth in exports to major trading partners continues to slow – as the impacts of base effects continue to erode. In year-on-year terms, the largest increase was in exports to East Asia – up by 19.5% yoy – while exports to the United States increased by 13.4% yoy and exports to the European Union-27 + the United Kingdom rose by 13.1% yoy.

- Compared with the level of exports in July 2019, exports have grown most rapidly to Europe – up by 32.3% – followed by East Asia at 30.3%. Growth in exports to the United States was comparatively weaker, increasing by 27.6%. In part, this slightly slower rate of growth may reflect the impact of US tariffs on the demand for goods produced in China.

RETAIL SALES AND INFLATION

RETAIL SALES GROWTH

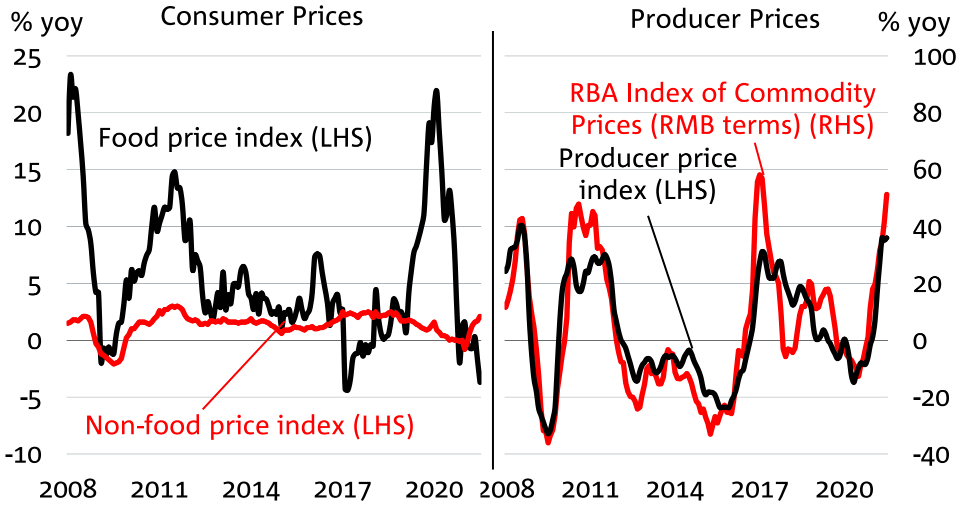
Sales growth slows again; mom decline highlights weakness



Source: CEIC, NAB Economics

CONSUMER AND PRODUCER PRICES

Producer prices surge; non-food prices also higher



Source: CEIC, RBA, NAB Economics

- Nominal growth in China's retail sales slowed once again – increasing by 8.5% yoy (down from 12.1% yoy in June) – with diminishing base effects a contributor. Retail price inflation was marginally softer in July than in June, which meant that real retail sales rose by 6.5% yoy (down from 9.8% yoy previously).

- That said, base effects alone do not explain the slowdown – with month-on-month retail sales (seasonally adjusted) decreasing by 0.13% (compared with a 0.48% mom increase in June). This could reflect the impact of China's latest COVID-19 outbreak, although it is worth noting that this series has been highly volatile post China's COVID-19 recovery.

- Headline consumer prices grew marginally more slowly in July – with the consumer price index rising by 1.0% yoy (from 1.1% yoy in June). This easing was driven by falling food prices.

- The food price index fell by 3.7% yoy, compared with a 1.7% yoy fall in June. Meat prices – primarily pork – remain a major driver of this trend. Pork prices fell by 43.5% yoy, reflecting the greater supply availability of the meat as the country continues to recover from the African swine fever outbreak across much of 2018 and 2019. Fresh outbreaks of the disease remain a risk, but so far have not impacted supply. Fresh vegetable prices also fell in year-on-year terms – down by 4.0% yoy – while fresh fruit prices rose by 5.2% yoy.

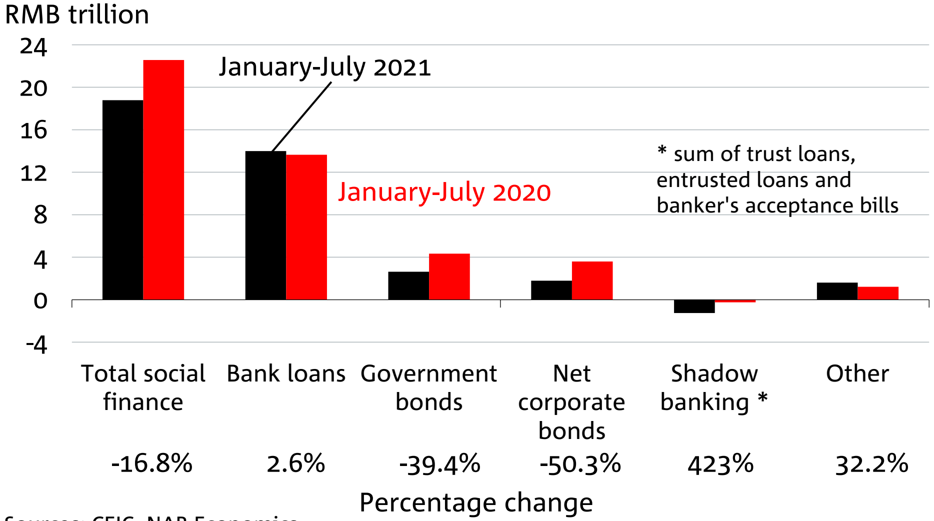
- Non-food prices rose strongly – up by 2.1% yoy (from 1.7% yoy in June) – the largest increase since November 2018. Vehicle fuel prices have been a major contributor to the upward trend in non-food prices – increasing by 24.7% yoy in July.

- Producer prices have continued to increase strongly – up by 9.0% yoy in July (compared with 8.8% yoy in June). Rising global commodity prices have contributed to this trend – leading to higher input costs for China's manufacturers – with the RBA Index of Commodity Prices (converted to RMB terms) rising by 51.3% yoy (compared with 40.8% yoy in June).

CREDIT CONDITIONS

NEW CREDIT ISSUANCE

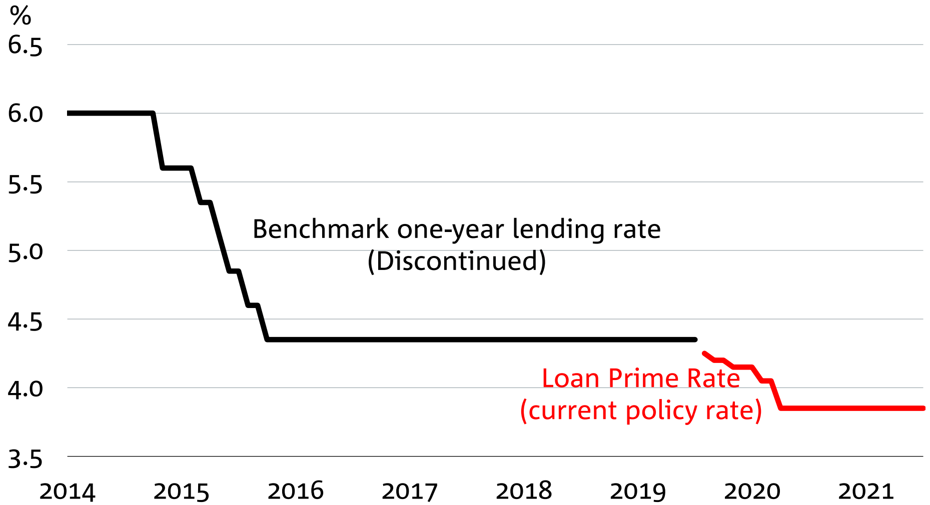
Steep falls in bond issuance drives yoy decline in credit



Sources: CEIC, NAB Economics

CHINA MONETARY POLICY

Concerns around domestic economy has raised prospect of cut



Source: CEIC, NAB Economics

- New credit issuance slowed significantly in July – down from RMB 3.7 trillion to RMB 1.1 trillion. Although July is typically a weaker month, this was the lowest issuance since February 2020 – the peak of China's COVID-19 shutdown.

- In the first seven months of 2021, new credit issuance totalled RMB 18.8 trillion, a decrease of 16.8% yoy. During this period, bank lending continued to expand – increasing by 2.6% yoy to RMB 14.0 trillion (or almost 75% of the total).

- In contrast, non-bank lending has continued to fall – down by over 46% yoy over the first seven months to RMB 4.8 trillion. A steep decline in both corporate and government bond issuance was the key driver of this decline – down by 50% yoy and 39% yoy respectively. However, there was also a fall in the stock of shadow banking products.

- The People's Bank of China (PBoC) argued in its latest monetary policy report that producer price inflation was controllable – with some of the increase being temporary – and that it would continue its stable monetary policy – noting that interest rates are at "a reasonable level".

- That said, the bank also noted downside risks to the economy, with parts of the domestic economy still struggling and export growth likely to slow. The recent COVID-19 outbreak that started in mid-July presents some additional risk. This has triggered some speculation that the PBoC could implement further cuts to the Required Reserve Ratio (similar to the cut in July), or even cut interest rates (which have been on hold since April 2020) – albeit the latter would not appear to be consistent with its comments around stable policy.

Group Economics

Alan Oster
Group Chief Economist
+61 3 8634 2927

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Dean Pearson
Head of Behavioural & Industry Economics
+(61 3) 8634 2331

Australian Economics and Commodities

Gareth Spence
Senior Economist – Australia
+(61 4) 36 606 175

Phin Ziebell
Economist – Agribusiness
+(61 4) 75 940 662

Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 3837

Steven Wu
Economist – Behavioural & Industry Economics
+(613) 9208 2929

International Economics

Tony Kelly
Senior Economist
+(61 4) 77 746 237

Gerard Burg
Senior Economist – International
+(61 4) 77 723 768

Global Markets Research

Ivan Colhoun
Global Head of Research
+61 2 9237 1836